

Report on IFRS enforcement in 2011

The activities of Finnish listed companies in late 2011 were marked by increasing uncertainty, triggered by the euro crisis. Due to the crisis, the European Securities and Markets Authority (ESMA) in late 2011 issued a public statement on the accounting treatment of GIIPS sovereign debt in banking-sector financial statements and disclosures related to sovereign debt. The euro crisis thus also reflected on FIN-FSA's IFRS enforcement, which focused on compliance with standards on financial instruments in the banking sector, to maintain confidence in financial information.

FIN-FSA's IFRS enforcement, for the first time, included inspections of IFRS financial statements of supervised entities. In the period under review, FIN-FSA inspected the 2010 consolidated financial statements of two banks. The focus was on the enforcement of the impairment recognition process for loans and receivables from the perspective of IFRSs. FIN-FSA drew the attention of banks to the coverage of guidelines concerning the impairment recognition process and the disclosure of adequate information in the financial statements.

The market value of Finnish listed companies declined in 2011 by approximately one-third, and therefore, in IFRS enforcement, FIN-FSA continued to pay special attention to the goodwill impairment testing. In accordance with established enforcement practice, the enforcement of the goodwill impairment testing focused on companies with the largest goodwill in euro terms and for which goodwill accounts for a significant portion of equity. FIN-FSA's objective is to develop the goodwill impairment testing processes in the listed companies and thereby improve the quality and reliability of the financial statements.

Segment reporting was a new focus area of IFRS enforcement. FIN-FSA observed deficiencies in the identification of operating segments according to the standard-based two phase approach.¹ This type of an approach may lead to a situation in which segment information disclosed in a financial statement does not comply with the IFRSs. ESMA also paid attention to the problems relating to IFRS 8, which are due to weaknesses in the standard itself and a failure to fully comply with its requirements. The objective of ESMA is a more harmonised pan-European application of the IFRS

¹ IFRS 8 *Operating Segments*.

standard. Segment reporting, providing information on for example the performance of different business lines or geographical areas, is key financial statement information for investors' decision-making.

Scale and focus of IFRS enforcement

The table below describes the scale of IFRS enforcement in 2011 and 2010, by type of enforcement.

Type of enforcement	Number of enforcement events in 2011	Number of enforcement events in 2010
Full review	16	16
Enforcement by theme	4	26
Reactive enforcement	8	13
IFRS enforcement of prospectuses	6	4
Total	34	59

A total of 36 enforcement letters were sent to 16 companies (2010: 51 letters) selected according to a risk-based approach. FIN-FSA sent a total of 7 enforcement letters on selected themes (2010: 58 letters).² In addition, FIN-FSA responded on the basis of companies' stock exchange announcements or complaints, sending 11 enforcement letters (2010: 27 letters). The number of complaints increased on the previous year, whereas enforcement on the basis of companies' stock exchange announcements decreased. The shortage of resources at the Financial Reporting Division affected the scale of enforcement during the year under review.

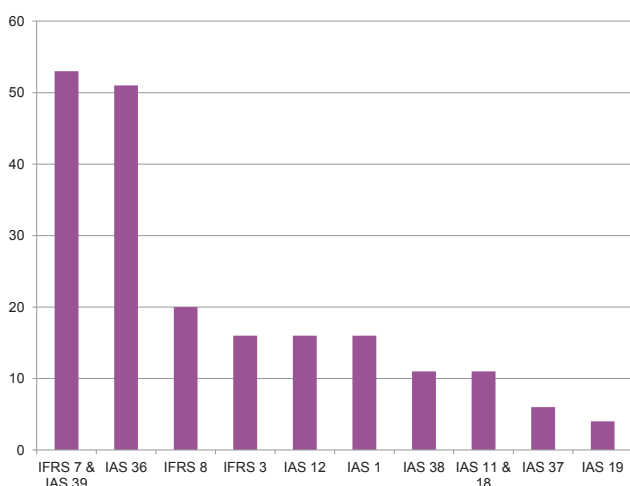
² In enforcement by theme, the number of letters is not comparable between years, as the number depends on the scope of the theme and the number of selected companies. If the theme is narrow and the group of companies is large, the number of letters will be large, as in 2010.



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The table below shows the IFRS standards that were the focal points in the enforcement of the 2010 financial statements.

Focus of enforcement by standard (number of questions/observations)



Due to the market situation, the majority of enforcement observations focused on the application of the standards on financial instruments (IFRS 7 and IAS 39). The application of the standard on Impairment of Assets (IAS 36) was also subject to extensive enforcement, as the theme of IFRS enforcement in 2011 was goodwill impairment testing. Enforcement by theme is the thorough review of one part of the financial statement, with a large number of detailed questions for the companies. The enforcement of the following standards also resulted in a large number of observations on segment reporting (IFRS 8), Business Combinations (IFRS 3), Income Taxes (IAS 12), Presentation of Financial Statements (IAS 1), Intangible Assets (IAS 38), and the standards on revenue recognition (IAS 11 and IAS 18).

Procedures of IFRS enforcement and measures required by companies as a result of enforcement observations

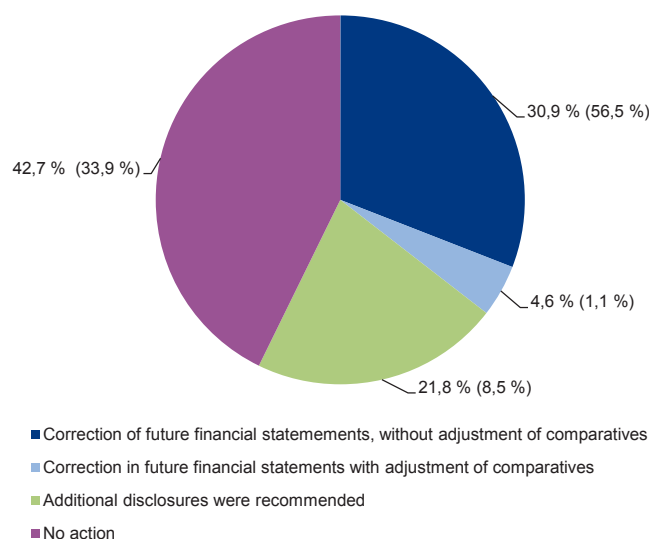
During the year, enforcement procedures were further developed. In enforcement letters, the questions focused on significant financial reporting issues, and consequently

the number of questions per letter declined compared to 2010. Other minor observations that the companies were requested to take into account were presented in an annex to the enforcement letter. The companies decide for themselves how to take these observations into account in their reporting.

The enforcement of IFRSs included for the first time on-site inspections of FIN-FSA's listed supervised entities. The inspections are conducted in accordance with FIN-FSA's inspection process, and they include on-site inspections and the preparing of an individual inspection programme. An inspection differs from the statutory audit of financial statements in terms of objective, content and scope. FIN-FSA's inspections have a wider perspective than an audit as key issues concerning the entire banking and insurance sectors may be taken into account. FIN-FSA does not do a second audit.

The diagram below shows the distribution of measures required of companies based on individual enforcement observations in 2011 and 2010. Regarding some enforcement observations companies corrected their future financial statements retrospectively with adjustments of comparatives. In nearly one-third of all the observations, companies were requested to make correction of future financial statements, without adjustment of comparatives. Additional

Distribution of measures required of companies based on individual enforcement observations in 2011 and 2010



disclosures were recommended in nearly one-fourth of the observations; for the other observations, FIN-FSA did not require any measures.

Communication of IFRS enforcement results and other communication

According to the established practice, FIN-FSA in early December arranged two events on financial reporting for listed companies, in which approximately 140 representatives participated. The primary purpose of the events was to inform listed companies and auditors about FIN-FSA's IFRS enforcement observations in 2011, so that the companies can take them into account in future financial reporting.³ The purpose was also to inform the listed companies about the IFRS enforcement process, FIN-FSA's priorities for the enforcement of IFRSs in 2012 and to notify of possible changes in enforcement.

In addition to the IFRS enforcement, the events focused for example on ESMA's role in the enforcement of financial statements and other disclosure obligations, topical issues relating to disclosure obligations under the Securities Markets Act, and enforcement observations.

In the year under review, nine articles on IFRS enforcement were published in the *Markkinat* bulletin (Markets, in Finnish only). The purpose of the articles is to inform about the IFRS enforcement activities and other enforcement observations. The articles discussed segment reporting, the new standards on revenue recognition and leases, the treatment of sovereign debt in IFRS financial statements, materiality in the financial reporting, new enforcement decisions published by ESMA, as well as ESMA's role in the auditing issues. The Annex to this report includes a detailed list of the topics of the articles (in Finnish only).

International activities

International activities focused on compliance with standards on financial instruments in the banking sector. Finland participated in preparations concerning ESMA's public statements on the treatment of sovereign debt in IFRS financial statements and related disclosures in the notes

to the financial statements. ESMA in July published its first statement, emphasising disclosure of sufficient information in the notes to the financial statements.⁴ In its second public statement, published in November, ESMA requested issuers to carefully analyse the existence of impairment for sovereign debt-related financial assets.⁵ The purpose of ESMA's statements is to promote consistent accounting treatment in 2011 IFRS financial statements.

Finnish representatives participated in the enforcement sessions of the ESMA working group EECS⁶. Eight such working sessions were held during the year. The purpose of the EECS is to increase convergence amongst enforcers' activities across Europe.

EECS maintains a database on individual enforcement decisions taken by national enforcers. Finland submitted to the database one decision, concerning goodwill impairment testing. In addition, Finland submitted to EECS four emerging issues for discussion, relating to the following IFRS issues:

- identification of cash-generating units in goodwill impairment testing;
- allocating goodwill to disposed operation;
- application of the so-called tainting rule for held-to-maturity investments; and
- identification of the chief operating decision maker in segment reporting.

ESMA published in 2011 the 10th and 11th Extract from the EECSs Database of Enforcement.⁷ The enforcement decisions – so far 119 in all – have been published since 2007. The aim is to promote the consistent application of IFRSs

³ Presentations at the events and a summary of FIN-FSA's selected IFRS enforcement observations in 2011 are available on FIN-FSA's website (in Finnish only) <http://www.finanssivalvonta.fi/fi/Listayhtiolle/IFRS/Julkaisut/Esitykset/Pages/Default.aspx>.

⁴ ESMA Statement on disclosures related to sovereign debt to be included in IFRS financial statements (28 July 2011).

⁵ ESMA Statement on sovereign debt in IFRS financial statements (25 November 2011).

⁶ European Enforcers' Coordination Sessions. EECS discuss the application of IFRSs in financial statements, in terms of technical application and enforcement measures.

⁷ All the published decisions are available on FIN-FSA's website at <http://www.finanssivalvonta.fi/fi/Listayhtiolle/IFRS/Julkaisut/EECS/Pages/Default.aspx>

and the transparency of enforcement in Europe. FIN-FSA in 2011 prepared for the first time Finnish summaries of the most significant new enforcement decisions, published in two issues of Markkinat bulletin.⁸ The objective of FIN-FSA is to increase public awareness of the actions of European enforcers.

FIN-FSA also participated in the consultation work of the European securities and banking regulators as regards commenting on new draft IASB standards. ESMA's IFRS group⁹ took strategic policy decisions to deepen cooperation with investors and analysts and to emphasise the consistent application of financial reporting requirements and their enforcement in the commenting of IFRS requirements¹⁰.

In addition, FIN-FSA participated in the work of the ESMA working group Materiality of financial reporting. The resulting document "*Considerations of Materiality in Financial Reporting*" was issued for consultation in late 2011.¹¹ The purpose of the document is to discuss from the point of view of regulation and established practice the key considerations affecting the assessment of materiality. The paper on materiality was presented to listed companies and other interested parties at an event arranged for listed companies in December. A separate meeting was held in January for auditors and representatives of the Ministry of Employment and the Economy.

Cooperation with the supervisor of auditors

FIN-FSA has participated in the supervision of auditors through its membership in the Auditing Board of the Central Chamber of Commerce. Cooperation with the Secretariat of the Auditing Board started in 2010, and cooperation has continued so that FIN-FSA and the Auditing Board focus their supervision on the same financial statements. FIN-FSA assessed the preparation of financial statements, while the

Auditing Board assessed the manner in which the auditors audited them. The purpose of the cooperation is to enhance the enforcement of financial reporting pursued by competent authorities in the financial markets, with the aim of promoting confidence in financial reporting.

Cooperation will increase further with the widening scope of the Auditing Board's proactive supervision. FIN-FSA aims to inform the listed companies about the supervision of auditors, which is closely connected with the financial reporting of the companies.

Cooperation with interested parties

In the area of national accounting legislation, FIN-FSA promoted good accounting practice by participating in the work of the Accounting Board of the Ministry of Employment and the Economy.

In May 2011 the European Financial Reporting Advisory Group¹² arranged an outreach meeting in cooperation with FIN-FSA and the Ministry of Employment and the Economy and the Confederation of Finnish Industries. The topic of the meeting was the new draft IASB standards on revenue recognition and leases. At the meeting, the listed companies were informed of the changes made to the draft standards by IASB (and FASB) based on comments received. The listed companies were also given the opportunity to express their views on whether decisions by IASB (and FASB)¹³ have eliminated the concerns related to the original draft standards. Some 80 participants attended the meeting.

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⁸ Markkinat (Markets) 1/2011 and 3/2011, in Finnish only.

⁹ IFRS project group operates under the Corporate Reporting Standing Committee (CRSC). CRSC conducts ESMA's work on issues related to financial reporting, audit and storage of regulated information.

¹⁰ ESMA's strategic policy decisions on influencing IFRS – the road to more consistent commenting (Markkinat 1/2012 bulletin, in Finnish only).

¹¹ Considerations of materiality in financial reporting – ESMA consultation paper (Markkinat 4/2011 bulletin, in Finnish only).

¹² EFRAG (European Financial Reporting Advisory Group) comments from the European perspective on ISAB's proposals for new standards, interpretations and changes to them, and assists the European Commission by advising on the adoption of the finalised standards and interpretations as EU legislation.

¹³ Financial Accounting Standards Board, the US authority that establishes financial accounting and reporting standards.



Annex: The Financial Reporting Division's news items in 2011¹

Presentations

- December 2011 Events for listed companies – Presentation material and selected IFRS enforcement observations in 2011 (in Finnish only)

News releases

- ESMA guidance on consistent accounting treatment of sovereign debt in IFRS financial statements (33/2011, 29 November 2011, in Finnish only)
- Report by the European Securities and Markets Authority on concerns relating to the implementation of IFRS 8 – Operating Segments (32/2011, 28 November 2011, in Finnish only)
- European Securities and Markets Authority underlines the disclosures of sovereign debt in IFRS financial statements (20/2011, 5 August 2011)

Markkinat bulletin and other articles (in Finnish only)

- Considerations of materiality in financial reporting – ESMA consultation paper (Markkinat 4/2011 bulletin).
- ESMA guidance on consistent accounting treatment of sovereign debt in IFRS financial statements (Markkinat 4/2011 bulletin)
- ESMA report on concerns relating to the implementation of IFRS 8 – Operating Segments (Markkinat 4/2011 bulletin)
- Segment reporting attracts Europe-wide interest (Markkinat 3/2011 bulletin)
- ESMA publish new enforcement decisions (Markkinat 3/2011 bulletin)
- ESMA statement on disclosures related to sovereign debt to be included in IFRS financial statements (Markkinat 3/2011 bulletin)
- EFRAG outreach meeting on new IFRS standards: revenue recognition and leases (Markkinat 2/2011 bulletin), Presentations
- European financial supervisors comment on auditing regulation (Markkinat 2/2011 bulletin)
- ESMA publish new enforcement decisions – Finnish summary available (Markkinat 1/2011 bulletin)

IFRS reports

- Report on IFRS enforcement in 2010

Extracts from EECS's Database of Enforcement

- ESMA publishes 11th Extract from the EECS's database of enforcement (16 August 2011)
- ESMA publishes 11th Extract from the EECS's database of enforcement (8 March 2011)

Press releases by the European Securities and Markets Authority (ESMA)

- ESMA issues a public statement on sovereign debt in IFRS financial statements (25 November 2011)
- ESMA launches a consultation on the considerations of materiality in financial reporting (10 November 2011)
- ESMA publishes the Review of European enforcers on the implementation of IFRS 8 – Operating Segments (10 November 2011)
- ESMA publishes the Activity Report of IFRS enforcement in 2010 (21 October 2011)
- ESMA Statement on disclosures related to sovereign debt to be included in IFRS financial statements (28 July 2011)

¹ <http://www.finanssivalvonta.fi/fi/Listayhtiolle/IFRS/Julkaisut/Esitykset/Pages/Default.aspx>